

Commercial Lease; Related-Party Transactions

• Why am I subject to the Commercial Lease tax?

The Gilbert Tax Code imposes the privilege tax on the *gross income* of every *person* engaging in the *business* of renting, leasing or licensing for use real property.

• ...but I own the building and operate the business that occupies the building.

The legal owner of your property is one distinct person or entity, and another distinct person or entity occupies the property.

The Tax Code respects the individuality of every taxpayer or person. *Person* refers to every separate and distinct entity, legal or natural. Examples of persons are; individual, firm, partnership, joint venture, association, corporation, estate, trust, receiver, syndicate, broker, the Federal Government, this State, or any political subdivision or agency of this State.

• ...but I'm not in business.

The property owner is benefiting from owning a property that someone else is occupying. If the owner were to rent the property to an unrelated party, they would be generating income. The owner is either receiving funds from the occupant to pay its bills or having the occupant pay the expenses of owning the property.

The term *Business* means all activities or acts, personal or corporate, engaged in and caused to be engaged in with the object of gain, benefit or advantage, either direct or indirect, but not *casual activities or sales*.

The definition of a *casual activity or sale* specifically excludes any transactions or sales relating to real property.

• ...but my bank made me set up a separate company to get my loan.

In the process of obtaining financing from a bank, the lender may express their concern about liability from your business or personal actions affecting their ability to foreclose on the property in the event that you do not make your payments. If you transfer ownership of the property into a separate legal entity from all of your other operations, they can be assured that the property is free from liability exposure that may arise from your other activities.

Creating a limited liability company, and transferring the property into the LLC is often times the least expensive way to alleviate the bank's concerns, and ensure that you get the loan. The bank does not require that you set up a limited liability company. They did not make you transfer the property. You chose to do this so that you could do business with the bank.

• ...but I don't make any money.

If the owning entity makes no money, who pays the expenses of owning and maintaining the property? If the person or entity who occupies the property is paying those expenses, the property owner is benefiting from the reduction or forgiveness of debt.

Gross income includes all receipts, cash, credits, barter, exchange, reduction of or forgiveness of indebtedness, and property of every kind or nature derived from a sale, lease, license for use, rental, or other taxable activity.

In further defining and determining *gross income*, the Tax Code discusses the treatment of related party transactions. Transactions between affiliated companies or persons, or in other situations where the relationship between the parties is such that the gross income does not represent a reasonable, fair market value of the transaction, the City must determine the fair market value to which the privilege tax will apply.

The Town of Gilbert desires to work with the taxpayer in determining a representative fair market value for the relationship. Market conditions, amount of space occupied, and property costs incurred by the tenant entity are some of the facts that will be taken into consideration when arriving at a fair market value on which to apply the privilege tax.